



# BLM Contemplates Oil and Gas Royalty Reform

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The U.S. Bureau of Land Management (BLM) has taken the first step towards modifying royalty rates and other payments, fees, assessments, and bonding requirements associated with oil and gas activity on public lands for the first time in nearly 30 years. On April 21, 2015, BLM published in the *Federal Register* an Advanced Notice of Proposed Rulemaking (ANPR) announcing that it is exploring potential changes to its regulations governing onshore oil and gas royalties, payments, fees, assessments, and bonding requirements, and seeking public input and recommendations on the form that the revisions should take. See “Oil and Gas Leasing; Royalty on Production, Rental Payments, Minimum Acceptable Bids, Bonding Requirements, and Civil Penalty Assessments,” 80 Fed. Reg. 22,148 (Apr. 21, 2015). The scope and scale of these changes could potentially impact the willingness of oil and gas companies to further expand operations on public lands.

## Background

In the last fifteen years, the United States has experienced an energy renaissance. Developments in directional drilling and hydraulic fracturing techniques have allowed companies to pursue hydrocarbon deposits that previously were either inaccessible or commercially impracticable. These developments have precipitated a “shale boom,” allowing the United States to become the global leader in natural gas production, and positioning the country to become a net energy exporter sometime between 2022 and 2040.

BLM alone manages 245 million surface acres and 700 million subsurface acres, most of which is concentrated in the west and in Alaska on lands overlapping some of the country’s major shale formations. In fiscal year 2014, production occurring on federal lands yielded \$27 billion in oil and gas receipts and generated nearly \$3.1 billion in federal onshore royalties. Of this \$3.1 billion in onshore royalties, half was distributed to the states in which the federal leases were located, except in Alaska, where the State is entitled to 90 percent of royalty receipts. The remaining federal royalty revenues flow into the U.S. Treasury, where they are used to fund infrastructure projects, conservation efforts, and education.

## Overview of the ANPR

The ANPR contemplates a number of sweeping changes, including adjusting the fixed 12.5 percent royalty rate on competitively-bid federal onshore leases. In addition, BLM is considering increases to annual rental payments on leased federal lands, minimum acceptable bids for competitive lease sales, and minimum bond amounts required to ensure complete and timely reclamation and restoration following well abandonment or cessation of operations. BLM also is exploring whether it should eliminate the cap on civil penalties for various regulatory violations.

## Royalty Adjustment

BLM’s existing regulations prescribe a fixed 12.5 percent royalty for all competitively-issued oil and gas leases. In the ANPR, BLM is considering amending its regulations to give the Secretary of the Interior discretion “to adjust royalty rates in response to changes in the oil and gas market.” This approach could create a more dynamic methodology to royalty rate-setting that includes increases or decreases in the rate to reflect market conditions. Even with a new approach, BLM would remain focused on the goal of obtaining “a fair return on the oil and gas resources extracted from BLM-managed lands.” Any rate adjustment would be prospective, applying only to new leases executed after promulgation of a final rule.

Through the ANPR, BLM seeks comments and recommendations on a number of royalty-related issues, including:

- Whether or not the existing rate provides the public with a fair return;
- Whether BLM should factor in the potential effect of a rate change on production;
- Whether BLM should employ a fixed rate, a sliding-scale rate, or some other rate structure;
- Whether BLM should impose different rates based on region, state, lease sale, formation, resource type, or other category; and
- Whether the Secretary of the Interior should be vested with authority to amend the royalty rate on a lease-by-lease basis.

#### **Annual Rental Payments**

Under law, lessees are required to pay an annual rental fee for the exclusive right to develop oil and gas resources on a particular lease tract. BLM's annual rental payments have not been updated since 1987. Currently, BLM charges \$1.50 per acre or fraction thereof in the first five years of a lease and \$2.00 for every year thereafter. The ANPR anticipates updating the minimum annual rental payments, taking into account inflation or other market factors. BLM also contemplates proposing a rental scheme whereby payments would escalate over time.

#### **Minimum Acceptable Bid**

All onshore oil and gas leases must be offered as part of a competitive lease sale. Presently, bids on lease areas must at least meet the minimum acceptable bid amount of \$2.00 per acre. The minimum acceptable bid has never been updated, even though Congress gave the Secretary of the Interior discretion to establish a higher minimum acceptable bid beginning in 1989. In its ANPR, BLM explains "that most parcels sell for well in excess of the current minimal acceptable bid," and notes that it is considering changes to the bid minimum to "enhance[e] financial returns to the United States" without discouraging competitive bidding.

#### **Bonding**

The Mineral Leasing Act authorizes the Secretary of the Interior to require "an adequate bond, surety, or other financial arrangement" prior to surface-disturbing activities on a lease "to ensure the complete and timely reclamation of the lease tract, and the restoration of any lands or surface waters adversely affected by lease operations." BLM has not amended its minimum bonding requirements since 1960. The ANPR notes that BLM is contemplating changes to bonding requirements because, at present, the requirements "do not reflect inflation and do not cover the costs associated with reclamation and restoration of any individual oil and gas operation."

#### **Civil Penalties**

BLM has the authority to assess penalties for a number of violations associated with oil and gas drilling activities on public lands, including for trespass, regulatory violations, and failure to permit lawful entry or inspection. BLM's civil penalty structure was established nearly three decades ago and has not been updated since. Further, the effectiveness of the penalties as a deterrent has been openly questioned in internal audits. In its ANPR, BLM raises the possibility of changes to its civil penalty assessments for various regulatory violations. These changes could include eliminating civil penalty caps altogether or increasing them.

#### **For more information**

Comments in response to the ANPR may further shape how BLM ultimately crafts a proposed rule. Comments are due by June 9, 2015. If you have any questions on the ANPR or any of BLM's regulatory

activities, please contact [Jonathan Simon](#), [R. Scott Nuzum](#), [Keith Coyle](#), or [Joseph Nelson](#) at 202-298-1800.

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